

## **STAFF REQUEST FOR PERMISSION TO PROCEED WITH FORMAL REGULATORY PROCESS FOR PROPOSED REGULATION 19133, RELATING TO THE IMPOSITION OF THE NOTICE AND DEMAND PENALTY**

The Franchise Tax Board's Filing Enforcement (FE) system identifies individual taxpayers who have not filed a personal income tax return when a return appears to be required based upon information available to the department. These nonfilers receive a formal "demand" letter that triggers a demand penalty under Revenue and Taxation Code section 19133 equal to 25 percent of the total tax liability before applying any payments or withholding credits, if the nonfiler fails to respond to the demand letter.

The department's historical administrative practice was to issue the demand letter immediately in all circumstances, thereby automatically triggering imposition of the penalty where there was a failure to respond by the nonfiler. However, effective January 1, 2001, the three-member Board directed staff to assess the demand penalty only against repeat nonfilers who have failed to respond to a notice within the last four years. This direction resulted in staff making adjustments in the FE program to differentiate between first time nonfilers and repeat nonfilers. Thus, the department now sends a Request for Tax Return to a first time nonfiler instead of a demand letter, with the result that the Request for Tax Return will not trigger a demand penalty upon failure to respond. A taxpayer will only be assessed the demand penalty where the taxpayer fails to timely respond to a current Demand for Tax Return and the taxpayer had failed to timely respond to a Request for Tax Return or a Demand for Tax Return at any time during the four-taxable-year period preceding the taxable year for which the current Demand for Tax Return is issued.

This is a new regulation that will codify the department's current practice as described above, which practice has been previously authorized by the three-member Board. This change has reduced the number of situations where the demand penalty is imposed and has been generally well received by the taxpayer community, so that staff requests permission to proceed directly to the formal regulatory process.

**Section 19133 is adopted to read:**

**§ 19133. Penalty For Failure to File Return Upon Notice and Demand.**

(a) In general. Revenue and Taxation Code section 19133 provides that if any taxpayer fails or refuses to file a return upon notice and demand by the Franchise Tax Board (FTB), the FTB may add a penalty of 25 percent of the amount of tax assessed pursuant to Revenue and Taxation Code section 19087 or of any deficiency tax assessed by the FTB concerning the assessment for which the return was required.

(b) Imposition of Penalty. For individuals subject to tax under Part 10 (Personal Income Tax Law), the notice and demand penalty under Revenue and Taxation Code section 19133 will only be imposed by the FTB if:

(1) the taxpayer fails to timely respond to a current Demand for Tax Return in the manner prescribed, and

(2) the FTB has proposed an assessment of tax under the authority of Revenue and Taxation Code section 19087, subdivision (a), after the taxpayer failed to timely respond to a Request for Tax Return or a Demand for Tax Return in the manner prescribed, at any time during the four-taxable year period preceding the taxable year for which the current Demand for Tax Return is issued.

(c) Definitions. For purposes of this regulation, the following definitions shall apply:

(1) Demand for Tax Return. A "Demand for Tax Return" means a written notice and demand for a return from the FTB, which advises the taxpayer that failure to respond in the manner provided and within the time prescribed will make the taxpayer liable for a penalty under Revenue and Taxation Code section 19133 for failure to file upon notice and demand.

(2) Request for Tax Return. A "Request for Tax Return" means a written notice and request for a return from the FTB, which does not advise the taxpayer that failure to respond in the manner provided and within the time prescribed will make the taxpayer liable for a penalty under Revenue and Taxation Code section 19133 for failure to file upon notice and demand.

(3) Timely Response. A "timely response" shall mean a response within the time period specified in the Demand for Tax Return or Request for Tax Return.

(d) Examples. The following examples are intended to illustrate the provisions of this regulation:

Example 1. Assume Taxpayer X has not filed a California personal income tax return for the 1999 taxable year. This is the first time that X has not filed a timely California personal income tax return. As a result of X's non-filing, the FTB mails a Request for

Tax Return to X on January 15, 2001. When X does not timely respond to the Request for Tax Return, the FTB issues a Notice of Proposed Assessment (NPA) on March 20, 2001, assessing tax, a late filing penalty, and interest, but the NPA does not include a notice and demand penalty under Revenue and Taxation Code section 19133.

Example 2. Assume the same facts as in Example 1, and X does not file a California personal income tax return for the 2001 taxable year. Because X received an NPA for not filing a return within the previous four years, the FTB issues a Demand for Tax Return for the 2001 taxable year. If X fails to timely respond to the Demand for Tax Return, the FTB will issue an NPA that includes tax, a late filing penalty, interest, and a notice and demand penalty under Revenue and Taxation Code section 19133.

Note: Authority cited: Section 19503, Revenue and Taxation Code.  
Reference: Section 19133, Revenue and Taxation Code.